United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

ORIGINAL

76-7278

To be argued by
JOHN J. LOFLIN

United States Court of Appeals
For the Second Circuit

MARGARET MARY McDONNELL MURPHY,
Plaintiff-Appellant

against

McDONNELL & CO., INCORPORATED and THE NEW YORK STOCK EXCHANGE by ROBERT W. HAACK, President,
Defendants-Appellees.

JAMES F. McDONNELL, JR., individually, as Trustee under the Will of James F. McDonnell and as Executor of the Estate of Anna M. McDonnell, and CHARLES E. McDONNELL, as Executor of the Estate of Anna M. McDonnell,
Plaintiffs-Appellants

against

THE NEW YORK STOCK EXCHANGE by ROBERT W. HAACK, THE NEW YORK STOCK EXCHANGE, INC., THE AMERICAN STOCK EXCHANGE by H. VERNON LEE, JR., Secretary, and McDONNELL & CO., INC.,
Defendants-Appellees.

On Appeal from the United States District Court for the Southern District of New York

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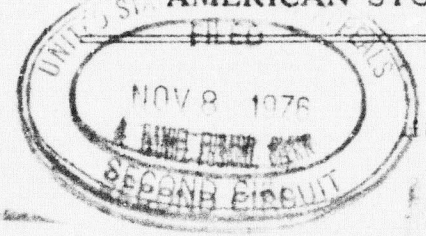
BRIEF FOR DEFENDANT-APPELLEE AMERICAN STOCK EXCHANGE, INC.



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BRIEF FOR DEFENDANT-APPELLEE AMERICAN STOCK EXCHANGE, INC.

Preliminary Statement

This brief is respectfully submitted on behalf of defendant-appellee American Stock Exchange, Inc. (the "Amex"). This is an appeal from a final order and judgment entered

after a jury trial before the Hon. Richard Owen, United States District Judge, which, among other things, awarded judgment to defendant American Stock Exchange, Inc., dismissing all claims against it in the action entitled *Anna M. McDonnell, et al.* v. *The New York Stock Exchange, et al.* (71 Civ. 1940) (the "*McDonnell* action"). The *McDonnell* action was consolidated for trial with *Margaret Mary McDonnell Murphy* v. *McDonnell & Co., Inc., et al.* (71 Civ. 461) (the "*Murphy* action"), in which the Amex is not a defendant.*

The order and judgment appealed from also awarded judgment to defendant New York Stock Exchange, Inc. (the "NYSE"), dismissing all claims against it in the *McDonnell* and *Murphy* actions. Although the judgment dismissing all claims against the Amex in the *McDonnell* action is based on grounds applicable only to defendant Amex, the judgment appealed from dismissing all claims against defendant NYSE is based on grounds which are equally dispositive of the claims asserted by the plaintiffs against the Amex in the *McDonnell* action. In the interest of brevity and to avoid repetitious arguments, defendant Amex refers to and incorporates herein by reference the statement of the case, issues presented, facts and arguments set forth in the brief submitted to this Court on behalf of defendant NYSE. The instant brief is limited to a presentation of the facts and law relevant to the dismissal of all claims against the Amex in the *McDonnell* action.

* On February 3, 1975, Mrs. Murphy commenced a separate action against the Amex, *Margaret Mary McDonnell Murphy* v. *The American Stock Exchange, Inc.* (75 Civ. 417 RO, S.D.N.Y.), which is in abeyance pending the determination of this appeal.

Statement of Issue Presented

Was it error for the District Court to dismiss all claims against the Amex for violating its duties and obligations under Section 6 of the Securities Exchange Act of 1934 to supervise and regulate the financial condition of a member firm, where the member firm was also a member of defendant NYSE, and pursuant to the Amex's rules and regulations, which were adopted pursuant to Section 6 of the 1934 Act and approved by the Securities and Exchange Commission, supervision and regulation of the financial condition of all dual NYSE-Amex member firms is allocated to and performed exclusively by the NYSE?

Statement of the Case

The plaintiffs* in this action seek damages arising out of certain subordinated loans which they made to McDonnell & Co., Inc. ("McDonnell & Co."), a brokerage firm which later become insolvent. By their amended complaint, the plaintiffs allege that various material misrepresentations and omissions were made by the principals of McDonnell & Co. with respect to the firm's financial condition in connection with the plaintiffs' investment in the firm, and also that defendants NYSE and Amex breached certain duties owed plaintiffs pursuant to Section 6 of the Securities Exchange Act of 1934 by failing to properly supervise the affairs of McDonnell & Co. and failing to advise the

* Unless otherwise noted, all references to "plaintiffs" and "amended complaint" refer to the plaintiffs and the amended complaint in the *McDonnell* action.

plaintiffs of the firm's true condition. (Amended Complaint, Vol. 1, at 39-73.)*

The thrust of plaintiffs' claim against the Amex is that "the Amex, in violation of the duties and obligations imposed upon [it] by Section 6 of the 1934 Act and contrary to the representations that [it] had made and contrary to [its] own Constitution and Rules, failed to exercise [its] supervisory and other powers over the business of McDonnell & Co. . . ." (Amended Complaint, ¶13, Vol. 1, at 44-45.)

The action was tried to a jury before the Hon. Richard Owen, United States District Judge. At the close of the presentation of the plaintiffs' case, and after oral argument by counsel for the Amex (Vol. 5, Tr. 1514-1526) and counsel for the plaintiffs (Vol. 5, Tr. 1564-1569), Judge Owen directed a verdict in favor of defendant Amex, dismissing all claims against it. (Vol. 5, Tr. 1642.)

Statement of Facts

During the trial, the plaintiffs presented very little evidence with respect to defendant Amex. The only Amex employees called to testify by plaintiffs was H. Vernon Lee, Jr., who at the time of the events set forth in the Amended Complaint was Vice President and Secretary of the Amex. Mr. Lee testified that pursuant to the Amex's rules and regulations in effect during the period 1968 through 1970, supervision of the financial condition of dual member or-

* All references to "Vol. —" refer to the volume and page citation in the Joint Appendix on file in this appeal. Page references to "Tr." refer to citations to the trial transcript set forth in the Joint Appendix.

ganizations of both the Amex and the NYSE, such as was McDonnell & Co., was allocated to the NYSE, and was not performed by the Amex. Pursuant to these rules, dual NYSE-Amex member organizations were subject to the rules of the NYSE as to audits and financial oversight, and at no time during the period 1968 through 1970 did the Amex's rules require McDonnell & Co., or any other dual member, to supply the Amex with reports relating to its financial condition, nor did they require the Amex to evaluate any financial information pertaining to dual members such as McDonnell & Co. (Vol. 5, Tr. 1431-1439). In addition to membership in the NYSE and the Amex, McDonnell & Co. was also a member of six other securities exchanges. (Vol. 3, Tr. 717.)

No evidence was introduced that the Amex was ever supplied with any information concerning the details of McDonnell & Co.'s financial condition, other than the facts that the firm was in violation of the NYSE's net capital rule, and that representatives of McDonnell & Co. were meeting with the NYSE to discuss the matter. Plaintiffs introduced into evidence a letter to Mr. Lee dated January 16, 1969, from Thomas A. McKay, Senior Vice President of McDonnell & Co., which advised in pertinent part:

> "We are informed by our auditors, Lybrand, Ross Bros. & Montgomery, that as a result of our annual audit as of October 31, 1968, we are under capital requirements as computed in accordance with Rule 325 of the New York Stock Exchange.
>
> • • •
>
> "We have already reported this fact to the New York Stock Exchange and are meeting with them next

week at their convenience to discuss this matter." (Plaintiffs' Exhibit 91 in evidence, Joint Appendix of Exhibits, at 43.)

The evidence also showed that neither of the plaintiffs, Anna M. McDonnell and James F. McDonnell, Jr., had any written or oral communication with the Amex during the period relevant to their claims, with the exception of communications relating to James F. McDonnell, Jr.'s application to become an allied member of the Amex at the time he became manager of McDonnell & Co.'s Detroit branch office. (Vol. 1, Tr. 243; Vol. 2, Tr. 560-61.)

ARGUMENT

Defendant Amex fully complied with its rules and did not breach any duties owed by it to plaintiffs under Section 6 of the 1934 Act.

The plaintiffs claim that the Amex breached duties and obligations imposed upon it by Section 6 of the 1934 Act and violated its own Constitution and rules by failing to supervise and regulate the financial condition of McDonnell & Co. Contrary to the plaintiffs' assertion, however, the Amex's rules, approved by the SEC, clearly provide that the Amex exercises no supervision over the financial condition of member firms which are also members of the NYSE, such as McDonnell & Co. Rather, supervision of the financial condition of dual NYSE-Amex member firms is performed exclusively by the NYSE. In the case of McDonnell & Co., the Amex fully complied with its rules and breached no duties owed to the plaintiffs under Section 6 of the 1934 Act.

A. The Amex's Duties Pursuant to Section 6 of the 1934 Act

Section 6 of the 1934 Act establishes certain requirements which national securities exchanges must meet in order to be registered as such with the Securities and Exchange Commission. Pursuant to Section 6 of the 1934 Act,* a national securities exchange is required to file with the SEC "copies of its constitution, articles of incorporation with all amendments thereto, and of its existing by-laws or rules or instruments corresponding thereto," as well as "copies of any amendments to the rules of the exchange forthwith upon their adoption." (Section 6(a)(3) and (4).) In order to qualify for registration, the SEC must find that the exchange "is so organized as to be able to comply with the provisions of this title and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors...." (Section 6(d).) Pursuant to Section 19(b) of the 1934 Act, the SEC is authorized "by rules or regulations or by order to alter or supplement the rules of [a national securities] exchange" if it determines "that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange...."

Beginning with *Baird* v. *Franklin,* 141 F.2d 238 (2d Cir.), *cert. denied,* 323 U.S. 737 (1944), the courts have recognized that a private right of action may exist against a securities exchange for a violation of the duties imposed

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* Reference is made to the statutory language in effect at the times relevant to the amended complaint herein. 15 U.S.C. §78a, *et seq.* (1970).

upon it by Section 6 of the 1934 Act. However, in determining whether a private right of action exists against an exchange for a violation of its Section 6 duties, the courts have read Section 6 to require only that the exchange enforce so far as within its powers those of its rules which are designed to insure fair dealing and to protect investors.* Thus, an exchange is not liable to an investor for a failure to enact adequate rules. As the Court in *Marbury Management, Inc.* v. *Kohn*, 373 F.Supp. 140 (S.D.N.Y. 1974), stated in dismissing an action against the NYSE for allegedly failing to enforce certain of its rules:

> "[T]he Exchange is merely required under Section 6 of the 1934 Act to enforce 'so far as within its powers' those of its rules which are designed to 'insure fair dealing and to protect investors.' *Baird* v. *Franklin, supra.* By granting the Exchange's registration and keeping that registration in force, pursuant to Section 6(d) of the 1934 Act, the Securities and Exchange Commission has found the rules of the Exchange adequate. While Section 6 provides a private right of action against the Exchange for a failure of *enforcement* of existing rules, it does not provide such an action for a

* It is well settled that not all violations of exchange adopted rules are *per se* actionable. See, e.g., *Colonial Realty Corp.* v. *Bache & Co.*, 358 F.2d 178, 181-82 (2d Cir. 1966), *cert. denied*, 385 U.S. 817, where Judge Friendly observed that "Congress did not intend violations of all rules adopted [by exchanges] under Section 6(b) to give rise to civil claims under federal law," and stated that in determining whether a particular violation is actionable "the court must look to the nature of the particular rule and its place in the regulatory scheme, with the party urging the implication of a federal liability carrying a considerably heavier burden of persuasion than when the violation is of the statute or an SEC regulation." Similarly, it should also be noted that allegations of exchange adopted rules "have been held to state a claim only where coupled with sufficient allegations of fraud on the investor." *Schonholtz* v. *American Stock Exchange*, 376 F.Supp. 1089, 1092 (S.D.N.Y.), *aff'd*, 505 F.2d 699 (2d Cir. 1974). See, *Buttrey* v. *Merrill Lynch, Pierce, Fenner & Smith*, 410 F.2d 135 (7th Cir.), *cert. denied*, 396 U.S. 838 (1969).

> failure to *enact* adequate rules. The remedy for such a claimed inadequacy in the Exchange's rules lies in Section 19(h) of the Securities Exchange Act of 1934 (15 U.S.C. §78s(b)), which authorizes the SEC to alter or supplement the rules of the Exchange." 373 F. Supp. at 143-44. (Emphasis in original.)

See, *Cutner* v. *Fried,* 373 F.Supp. 4, 8-9 (S.D.N.Y. 1974); *Kroese* v. *New York Stock Exchange,* 227 F.Supp. 519, 521 (S.D.N.Y. 1964).

In order to establish liability against the Amex under Section 6 of the 1934 Act for failing to supervise the financial condition of McDonnell & Co., plaintiffs must show that specific Amex rules were violated. As this Court held in *Schonholtz* v. *American Stock Exchange,* 505 F.2d 699, 700 (2d Cir. 1974), *affirming,* 376 F.Supp. 1089 (S.D.N.Y.), "no valid claim based on a failure to enforce rules can exist when no rules were violated."* As discussed below, pursuant to the Amex's rules, which were long-standing and approved by the SEC, the regulatory responsibility for supervising the financial condition of McDonnell & Co. and all other dual Amex-NYSE member firms was allocated to the NYSE.

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* The plaintiff in *Schonholtz* alleged violations of Amex Rules 170 and 177, which require specialist members to assist in the maintenance of a fair and orderly market and to report unusual activity or price change in stocks in which they deal. The Second Circuit affirmed the district court's dismissal of the complaint for failure to state a claim on the ground that "the facts alleged show no violations of [Amex] rules." 505 F.2d at 700.

B. The Amex's Rules Allocated Supervision of the Financial Condition of McDonnell & Co. to the NYSE

The Amex's rules with respect to the surveillance and supervision of the financial condition of its member firms clearly provide that supervision of the financial condition of member firms which are also members of the NYSE is not to be performed by the Amex, but by the NYSE. As discussed below, this allocation of regulatory responsibility to the NYSE for supervision of the financial condition of dual NYSE-Amex member firms has been approved by the SEC, and is recognized by Congress and the SEC as necessary to ensure the efficient and coordinated supervision of member firms required by Section 6 of the 1934 Act.

At the time of the events set forth in the amended complaint, five Amex rules were in effect which required certain reports by member firms with respect to their financial condition.* Amex Rule 441 required member organizations not exempted by Rule 440 to file with the Amex periodic statements of their financial condition and the condition of their accounts. However, such statements were not required from "a member firm or member corporation subject to the jurisdiction of another exchange unless the American Stock Exchange so directs." The provisions of Rule 442 required a member organization to make disclosures of its financial

* The rules discussed are those which were in effect on March 1, 1970, and were introduced at the trial as Plaintiffs' Exhibit 88 in evidence (Vol. 5, Tr. 1432-33). For the convenience of the Court, these rules are set out in the Appendix to this brief, at A1-A4. The rules in effect on March 1, 1970 are basically the same as those in effect at all times referred to in the amended complaint. The Amex's present rules with respect to the reports of financial condition of member firms are essentially the same as those discussed herein and are set forth in the Appendix, A5-A9.

condition to its customers. However, this requirement did not apply to member organizations subject to the financial reporting requirements of the NYSE. Rule 443 required an annual surprise audit of member organizations by an independent public accountant, but "[t]he provisions of this Rule shall not apply to a member firm or member corporation subject to the jurisdiction of another exchange unless the American Stock Exchange so directs."

Similarly, the provisions of Rule 444 regarding reports of capital borrowing by members or member organizations contained an exemption from such general reporting requirements for members and member organizations required to report such transactions to another exchange. (Rule 444(b)(6), Appendix, A3.) This rule was later amended to provide that this exemption applied only to transactions reportable to the NYSE. (Rule 444(d), Appendix, A7.) Finally, Rule 445 required a weekly statement of a member organization's obligations in respect of security underwritings, however "[s]uch statements need not be filed by a member firm or member corporation which submits similar statements to another exchange of which it is a member."*

* The amended complaint also contains an allegation that the Amex "failed to halt or prohibit the dissemination by McDonnell & Co. of false and deceptive public advertisements. . . ." (Amended Complaint, ¶13(e).) Like the supervision of McDonnell & Co.'s financial condition, the self-regulatory responsibility for supervising the advertising of dual NYSE-Amex member firms was also allocated to the NYSE. Amex Rule 481 provided (and still provides) that advertisements by Amex member organizations were subject to prior approval by the Amex, except that "[t]he provisions of this rule shall not apply to any advertisement of a member firm or member corporation subject to similar requirements of the New York Stock Exchange. . . ." (Appendix, A10.)

Both the SEC and Congress have recognized that this allocation of regulatory responsibility to the NYSE for supervision of the financial condition of dual NYSE-Amex member firms is necessary to avoid burdening the exchanges and their member firms with wasteful and duplicative reporting requirements, and to ensure the effective and coordinated regulation which is essential to the self-regulatory concept of Section 6 of the 1934 Act.

The Securities and Exchange Commission has long recognized the need for and approved of such allocations of regulatory responsibility. In a statement to the House Subcommittee on Commerce and Finance on November 17, 1971, then SEC Chairman William J. Casey summarized the situation:

> "All broker-dealers are, of course, under the direct supervision of the SEC; many are also under the jurisdiction of more than one self-regulatory agency. It has long been recognized that this situation could result in an unnecessary and burdensome duplication of regulatory activities. Consequently, over the years efforts have been made to avoid this duplication by allocating regulatory responsibilities among the various agencies involved. In our opinion, this allocation of responsibility has, on the whole, worked successfully.
>
> "The New York Stock Exchange and the American Stock Exchange (*for non-NYSE members*) assume the primary responsibility for regulation of their respective members, regardless of whether they are also members of a regional exchange." Hearing Before the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, H.R. Rep. No. 92-37b, 92d Cong., 1st Sess., 1713 (1972). (Emphasis added.)

Earlier, in its report to Congress entitled "Special Study of Securities Markets" (printed as H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963)) ("Special Study"), the SEC recognized the interest of the public, the regulatory agencies and the securities industry in avoiding wasteful and redundant regulation and encouraging coordination of regulation by allocating regulatory responsibilities in the most efficient and productive manner. In describing the situation as found to exist in the securities industry with respect to the need to allocate regulatory responsibilities, the Special Study reported:

> "The subject of coordination is of great importance if only because of the substantial number of broker-dealers with memberships in more than one self-regulatory body. Over 90 percent of all exchange member firms also belong to the NASD. The percentage of NYSE firms is even greater—as of February 28, 1962, 644 of 677 NYSE member firms, or 95 percent of the total, were also members of the NASD. Among the exchanges themselves multiple memberships are common. Over one-third of all regional exchange member firms also belong to one or both of the two major New York exchanges. Moreover, although each self-regulatory body has its own area of special concern, their spheres of regulation are not mutually exclusive. On some matters, such as their member firms' compliance with capital ratio requirements or Regulation T, their interests may largely overlap or coincide, and there is considerable overlapping in other areas where the regulatory concern of a particular agency extends beyond a particular market.
>
> "For the firm with multiple memberships, any unnecessary duplication of regulation, or lack of coordination in regulatory efforts, produces added costs and burdens that should be avoided to the extent possible.

> This is at least equally important for the regulatory agencies—with large tasks and limited budgets, it is obviously desirable to avoid duplication and achieve coordination and division of labor to the maximum extent consistent with the fulfillment of their respective responsibilities. . . ." 4 Special Study at 728-729. (Footnotes omitted.)

The authors of the Special Study recommended that in order to improve efficiency and economy of the total regulatory effort by avoiding duplication, "in the interests of the public, the regulatory agencies and the securities industry, further and continuing attention should be given to possibilities for coordinating efforts and allocating responsibilities in a more efficient and productive pattern. . . ." 4 Special Study at 738.* The Amex's rules allocating the regulatory responsibility for supervising the financial condition of dual NYSE-Amex member firms to the NYSE are, of course, intended to meet this need to achieve efficiency and coordination in self-regulation under Section 6 of the 1934 Act.

The Congress has also recognized this need for efficiency and coordination in self-regulation and, with the enactment

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* The SEC recently reiterated its mandate to regulatory agencies of the securities industry to coordinate their efforts and avoid duplication of regulation. On October 29, 1976, *The New York Times* reported that "in a major effort to reduce paperwork and simplify regulation" the SEC had, on October 28, "ordered more than a dozen industry organizations to submit their own plans on how this should be done and threatened to impose its own solution if they failed." *N.Y. Times*, October 29, 1976, at D5, col. 1. The *Times* reported SEC Chairman Roderick M. Hills as stating that "we are very hopeful that this program will result in significant reduction of unnecessary and costly duplication of regulatory effort and regulatory burden throughout the securities industry," and that "it had long been the commission's view that duplication of [regulatory] effort 'does not result in a higher level of investor protection commensurate with its cost, and should therefore be eliminated.'" *Id.*

of the Securities Investor Protection Act of 1970 (15 U.S.C. §§78aaa-78iii), expressly approved of the approach to effective self-regulation through a clear division of labor among self-regulatory bodies. This Act created the Securities Investor Protection Corporation (SIPC), whose membership includes nearly all broker-dealers, as a means of providing greater protection for the customers of broker-dealers. The SIPC legislation created new reporting and regulatory responsibilities for the self-regulatory organizations in order to supervise the financial condition of broker-dealers. Section 9(c) of the SIPC legislation provides that when a SIPC member is a member of more than one self-regulatory organization, the SIPC shall designate one of such organizations to inspect or examine the member "for compliance with applicable financial responsibility rules." Similarly, affirming the Congressional intent that allocation of supervisory responsibility to one self-regulatory organization is the favored means of monitoring the financial condition of broker-dealers, Section 9(f) of the SIPC legislation authorizes the SEC to

> "require any self-regulatory organization to inspect or examine any members of such self-regulatory organization in relation to the financial condition of such members. *In the case of a broker or dealer who is a member of more than one self-regulatory organization the Commission, to the extent practicable, shall avoid requiring duplication of examinations, inspections, and reports.*" (Emphasis added.)

The SEC has implemented this authority, most recently by the promulgation of Rule 17d-1, pursuant to Section 17 of the Exchange Act, as amended. 3 CCH Fed. Sec. L. Rep. ¶26,187A. SEC Release No. 34-12352 (April 20, 1976), ['75-'76 Transfer Binder] CCH Fed. Sec. L. Rep. ¶80,460.

Most recently, the Congress has provided, by the Securities Acts Amendments of 1975, (Pub. L. No. 94-29, 89 Stat. 104, June 4, 1975) that the concept of allocation of responsibility for supervision of member organizations by the self-regulatory organizations may be extended beyond regulation of member organizations' financial condition to encompass all phases of an exchange's regulation of a member's activities. Exchange Act, Section 17, as amended by Section 14 of the Securities Acts Amendments of 1975; Section 19, as amended by Sections 16 and 17 of the Securities Acts Amendments of 1975; and Section 23 as amended by Section 18 of the Securities Acts Amendments of 1975. *See,* Proposed Rule 17d-2, 3 CCH Fed. Sec. L. Rep. ¶26,187B, proposed in SEC Release No. 34-12352 (April 20, 1976), ['75-'76 Transfer Binder] CCH Fed. Sec. L. Rep. ¶80,460.

The Amex's rules with respect to supervision of the financial condition of dual NYSE-Amex member firms clearly provide that the NYSE, rather than the Amex, was to supervise the financial condition of McDonnell & Co. Not only were these rules approved by the SEC, but they are entirely consistent with what the Seventh Circuit Court of Appeals has described as "the avowed intention of Congress and the Securities and Exchange Commission that there be more coordination and less duplication of self-regulatory activities." *Hochfelder* v. *Midwest Stock Exchange,* 503 F.2d 364, 373, and n.7 (7th Cir. 1974), *cert. denied,* 419 U.S. 875 (1974).

C. The District Court Was Correct in Directing a Verdict for the Amex, and Dismissing All of the Plaintiffs' Claims Against the Amex.

The plaintiffs can point to no Amex rule or other authority which imposed upon the Amex any duty of supervision with respect to the financial condition of McDonnell & Co. That responsibility was clearly allocated to the NYSE and the Amex, at all times, relied upon and conducted itself in conformity with its rules. To impose liability on the Amex under the circumstances of this case, where supervision of the financial condition of McDonnell & Co. was allocated to the NYSE, would only frustrate the efficient and coordinated administration of the self-regulatory system which both the SEC and Congress have made every effort to promote.

Precisely the same issue was recently presented in *J. P. Foley & Company, Inc., et al.* v. *New York Stock Exchange and American Stock Exchange* (71 Civ. 2987, S.D.N.Y.), an action involving essentially the same issues as the instant case, where Judge Lasker, at the close of the presentation of the plaintiffs' case at trial, dismissed all claims against the Amex. Plaintiffs in the *Foley* action were individuals and a corporation who became subordinated lenders to Blair & Co., a dual Amex-NYSE member firm which, like McDonnell & Co., later became insolvent. Like the plaintiffs in the instant action, the *Foley* plaintiffs charged the Amex with failing to properly supervise the financial condition of Blair & Co. In addition, the plaintiffs in *Foley* alleged that James J. Ramsey, Jr., the president of Blair & Co., had supplied the Amex with details of the firm's deteriorating financial condition, and that the Amex had thereafter failed

to act. In its successful motion for a directed verdict, the Amex argued, as it argued below before Judge Owen, that since the regulatory responsibility for supervising the financial condition of Blair & Co. was allocated to the NYSE, as a matter of law the Amex breached no duties owed to the plaintiffs and was not liable for the loss of their investment in Blair & Co.

Judge Lasker agreed with this argument. In his oral opinion* Judge Lasker stated that even if the Amex had knowledge of the details of Blair & Co.'s financial condition, it had a right to rely on the NYSE to supervise and regulate the financial condition of Blair & Co.:

> "I . . . believe that a reasonable juror could not conclude that the American Stock Exchange had not acted reasonably in the circumstances because the American Stock Exchange had a right to assume . . . that Ramsey and his colleagues had brought the New York Stock Exchange up to date and fully informed them on Blair's affairs, as he had done with the Securities and Exchange Commission; and the American Stock Exchange had the right to assume that the New York Stock Exchange would supervise Blair appropriately in the circumstances and that the net capital problems, which would have been the same for both Exchanges, would have been as well regulated by the New York Stock Exchange as by itself, as would the other problems that Blair faced." (Appendix, at A14).

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* Judge Lasker did not set forth his grounds for dismissing all claims against the Amex in a written opinion. However, he did state these grounds orally, and those remarks are set forth in the transcript of the trial of the *Foley* action dated June 9, 1976, at pages 1599-1604. For the convenience of the Court, that portion of the trial transcript in the *Foley* action is set forth in the Appendix to this brief, at pages A11 through A16.

In the instant case, although McDonnell & Co. informed the Amex, by letter dated January 16, 1969, that it was in violation of the NYSE's net capital rule, it also advised that "we have already reported this fact to the New York Stock Exchange and are meeting with them next week at their convenience to discuss this matter." (Plaintiffs' Exhibit 91 in evidence, Joint Appendix of Exhibits at 43.) Clearly, the Amex had a right to assume that the NYSE, which had been informed of the problem and was in possession of the details of McDonnell & Co.'s financial situation, would take whatever regulatory steps were necessary and proper under the circumstances. Indeed, the Court below correctly found that the NYSE had done so, and had properly regulated the financial condition of McDonnell & Co.

Judge Lasker went on to observe that any attempt by the Amex, or any other exchange, to duplicate the supervision of dual members, such as Blair & Co., would have created a chaotic situation not in the best interests of subordinated lenders, the investing public or any other party:

> "Indeed, I must say I also agree with the American Stock Exchange's view, completely aside from whether dual supervision is excused as a matter of law, that as a matter of fact, if dual or multiple supervision of a brokerage house were attempted, particularly in the confused situation of Blair, it would have created chaos rather than have made a contribution of the welfare of the customers of Blair or the members of the firm or creditors or anyone else having a financial interest in the situation." (Appendix, at A15.)*

* Another district court has also ruled, in a factual context virtually identical to *Foley* and the instant case, that, as a matter of law, the Amex cannot be liable to an investor in a dual member organization where, as here, the duty to regulate the member was allocated

(footnote continued on next page)

These words, of course, apply equally to the case at hand. For instance, McDonnell & Co. was a member of six securities exchanges *in addition to* the Amex and the NYSE: The Boston Stock Exchange, the Pacific Coast Stock Exchange, the Detroit Stock Exchange, the Midwest Stock Exchange, the Honolulu Stock Exchange, and the Philadelphia-Baltimore-Washington Stock Exchange. (Vol. 3, Tr. 717.) It is not difficult to imagine the chaos and confusion which would have resulted if each of these securities exchanges attempted to supervise and regulate the financial condition of McDonnell & Co., requiring the firm to supply them with detailed financial information, undergo surprise audits, or take whatever steps each of these exchanges might have felt were necessary and appropriate in order to solve the firm's capital problems.

As the court in *J. R. Williston & Beane* v. *Haack*, ['74-'75 Transfer Binder] CCH Fed. Sec. L. Rep. ¶94,921, at 97,167 (S.D.N.Y. 1974) observed, "[i]t is beyond speculation that exchanges must be given broad discretion in mak-

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to the NYSE. On March 14, 1975, by an unpublished civil minute order, Judge Spencer Williams granted Amex's motion for summary judgment in *Carr, et al.* v. *New York Stock Exchange, Inc., et al.* (C-73-0367-SAW), an action brought in the United States District Court for the Northern District of California involving essentially the same issues as the instant case. Like the *Foley* plaintiffs, plaintiffs in the *Carr* action were individuals who purchased stock in Blair & Co. The *Carr* plaintiffs charged the Amex with failure to properly supervise the financial condition of Blair and with failure to disclose adverse information relating to the firm's financial condition at the time plaintiffs purchased their stock. In its motion for summary judgment, the Amex argued that since the regulatory responsibility for supervising the financial condition of Blair was allocated to the NYSE, as a matter of law the Amex breached no duties owed to the plaintiffs and was not liable for the loss of their investment in Blair. The court granted summary judgment dismissing all claims against defendant Amex. Counsel is aware of no authority contrary to that established by the *Foley* and *Carr* decisions.

ing the crucial determination as to whether the continued membership of a broker-dealer would involve a grave hazard of financial injury to the exchange or the firm's creditors." In the case of dual NYSE-Amex member firms whose financial condition is being supervised by the NYSE, this discretion rightly belongs to the NYSE. Any attempt by the Amex to duplicate that supervision would not only involve an unnecessary diversion of the limited resources of the Amex and its member firms, but it would also create the possibility of uncoordinated and inconsistent regulation of a single member firm by two or more separate self-regulating bodies.

Finally, to impose liability on the Amex in the circumstances of the instant case, where the Amex was under no duty whatsoever to supervise the financial condition of McDonnell & Co., would be tantamount to imposing absolute liability on the Exchange. Section 6 of the 1934 Act should not be read to subject a securities exchange to strict liability under any circumstances, least of all under the facts of the instant case. As the Seventh Circuit stated in *Hochfelder* v. *Midwest Stock Exchange, supra*:

> "Although the Section 6 duty of self-regulation is framed in broad language, 'to enforce so far as is within its powers', it is not a mandate of strict liability rendering the exchange a guarantor of all fraudulent schemes consummated by its members. . . . To so read Section 6 would tear at the very fabric of self-regulation, a burden which indeed no self-regulatory body could bear." 503 F.2d at 366.

In short, as the court below correctly found, under no reading of the facts or law in this case should the Amex be liable to the plaintiffs for the loss of their investment in

McDonnell & Co. The Amex fully complied with its rules with respect to supervision of McDonnell & Co., and breached no duties it owed to the plaintiffs pursuant to Section 6 of the 1934 Act.

Conclusion

For the foregoing reasons, it is respectfully submitted that the order and judgment of the court below, dismissing all claims against defendant Amex, should be affirmed in all respects.

Dated: New York, New York
November 8, 1976

Respectfully submitted,

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APPENDIX

AMEX RULES AS OF MARCH 1, 1970; RULES 440-445, CCH, AMERICAN STOCK EXCHANGE CONSTITUTION AND RULES, 1970.

Section 8. Reports of Financial Condition

¶ 9450 Firms and Corporations Not Doing Customer Business Must File a Certificate

Rule 440. Each member firm and member corporation shall file with the Exchange, unless the contrary is true, a statement signed by all partners of such member firm, all holders of voting stock of a regular member corporation or the executive officers of an associate member corporation certifying that such firm or corporation does not, and will not without first withdrawing such statement, carry margin accounts, free credit balances or securities in safekeeping for customers or make cash transactions for customers involving extensions of credit by such firm or corporation to, or the receipt by such firm or corporation of securities or monies from, customers and that such firm or corporation is not a clearing member of American Stock Exchange Clearing Corporation.

Amendments.
September 6, 1962.

¶ 9451 Firms and Corporations Doing Customer Business Must File Financial Reports

Rule 441. Every member firm and member corporation which has not on file with the Exchange a statement made pursuant to Rule 440 and every individual member of the Exchange who is a clearing member of American Stock Exchange Clearing Corporation shall file with the Exchange once in every four months during each twelve month period, unless the Exchange otherwise directs, a statement in a form prescribed by the Exchange of its financial condition and the condition of its accounts, including free credit balances and securities in safekeeping. The statement shall be signed by each partner of a member firm, all holders of voting stock in a regular member corporation or the executive officers of an associate member corporation unless for good cause shown the signature of one or more such persons is waived by the Exchange. The Exchange may prescribe similar or different forms of statement for the several reporting periods and may prescribe different reporting dates for different firms or corporations. The provisions of this rule shall not apply to a member firm or member corporation subject to the jurisdiction of another exchange unless the American Stock Exchange so directs.

Amendments.
August 4, 1960.
September 5, 1962.

¶ 9452 Disclosure of Financial Condition to Customers

Rule 442. Every member organization required under Rule 441 to submit reports of financial condition to the Exchange shall:

(a) within thirty-five days of the date after which the answer to each annual audited financial questionnaire is required to be filed with the Exchange, send to each customer either

(1) A statement of financial condition of the organization based upon such audit, including the independent public accountant's report on the statement of financial condition of the organization or, if the audit is not completed,

(2) a notice reading as follows:

"An audit of this organization as of (date) is now in process by independent public accountants. A financial statement of the firm (corporation), based on the audit now being conducted, will be mailed to all customers having an open account when such statements are available for distribution."

The financial statement based on the audited answers to the financial questionnaire shall be one which is prepared in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding audited statement, and shall include, in the basic statement or in accompanying footnotes, all informative disclosures necessary to make the statement a clear expression of the organization's financial condition and must be accompanied by the independent public accountant's report expressing an opinion on such statement; and

(b) make available at other times of the year at a customer's request or distribute to customers an unaudited statement of its financial condition based on its most recent report to the Exchange, or as of a date subsequent thereto, in a form approved by the Exchange.

Unaudited financial statements made available or distributed to customers at other times during the year shall follow in form and accounting principles the audited statements and shall be statements which in the opinion of the organization fairly present the financial condition of such organization.

Each monthly statement of account sent to a customer shall bear a legend reading as follows:

"A financial statement of this firm (corporation) is available for your personal inspection at its offices, or a copy of it will be mailed upon your written request."

• • • *Commentary*

.10 The term "customer" as used in the above Rule means any person or party who either at the time of requesting such a financial statement or at the time of the distribution of such annual statement has an open account with the member organization.

.20 Each member organization shall file with the Examinations Department of the Exchange, promptly after completion of the required annual audit, an exact copy of the statement of financial condition, based upon such audit, which the firm intends to submit to its customers. However, copies of other financial statements need not be filed with the Examinations Department unless the organization has not been in existence a sufficient length of time to have had such a required annual audit.

August 4, 1960.
September 6, 1962.
January 16, 1970.

¶ 9453 Independent Audits

Rule 443. The Exchange may require any member, member firm or member corporation to file with it, as of any date fixed by the Exchange, an audit, prepared by an independent public accountant, of his accounts, assets and liabilities, including free credit balances and securities held for

safekeeping, in such form as the Exchange may prescribe. The Exchange shall require the filing at least once in each twelve month period of such an audit by each member firm and member corporation. The provisions of this Rule shall not apply to a member firm or member corporation subject to the jurisdiction of another exchange unless the American Stock Exchange so directs.

Amendments.
April 5, 1962.
September 6, 1962.

¶ 9454 Reports of Member Indebtedness and Loans

Rule 444. Every member, member firm and general partner thereof and member corporation shall report to the Exchange on or before the tenth day of each month the following:

(a) Aggregate indebtedness arising from borrowings of cash or securities from any source whatsoever if such indebtedness equals or exceeds in any month the sum of $1,000. Each member, member firm and general partner thereof and member corporation of the Exchange shall include in aggregate indebtedness any monetary obligations arising out of past business transactions or associations.

(b) Each loan in the amount of $1,000 or more or series of loans aggregating $1,000 or more, whether cash or securities, made to any member, member firm or general partner thereof, member corporation or holder of voting stock in a regular member corporation. This report shall include any sum due from a member, member firm or member corporation of the Exchange arising out of past business transactions or associations.

The following need not be reported under paragraph (b) or included in computing aggregate indebtedness for the purpose of paragraph (a):

(1) Any loan fully secured by readily marketable collateral so long as the loan remains so secured.

(2) Any borrowing of securities for the purpose of effecting delivery against a sale where money payment equivalent to the market value of the securities is made to the lender and such contract is marked approximately to the market.

(3) Any borrowing on a life insurance policy which is not in excess of the cash surrender value of the policy.

(4) Any loan obtained from a bank, trust company, monied corporation or fiduciary on the security of real estate.

(5) Any loan transaction between general partners of the same firm, between parties to a joint-account registered with the Exchange or between holders of voting stock in the same regular member corporation.

(6) Any loan transaction of a member firm or partner thereof, member corporation or holder of voting stock in a regular member corporation required to report loan transactions to another exchange, provided, however, that this exception shall not be deemed to exclude the reporting by members, member firms and partners thereof, member corporations and holders of voting stock in regular member corporations of any loans to or borrowings from any regular member of the American Stock Exchange which are reportable under this Rule.

No report need be filed under this Rule for any month in which no increase or decrease in reported aggregate indebtedness, decrease in loans reported.

new loan of $1,000 or more or series of loans to any single borrower aggregating $1,000 or more is made.

Amendments.
September 6, 1962.

¶ 9455 Weekly Statement of Obligations and Net Positions in Respect of Security Underwritings

Rule 445. Every member firm or member corporation having obligations in respect of security underwritings shall submit to the Exchange weekly a statement of such obligations and the net positions resulting therefrom in such form as the Exchange may direct. Such statements need not be filed by a member firm or member corporation which submits similar statements to another exchange of which it is a member.

Amendments.
September 6, 1962.

Section 8. Reports of Financial Condition

¶ 9450 Organizations Not Doing Customer Business Must File a Certificate

Rule 440. Each member organization shall file with the Exchange, unless the contrary is true, a statement signed by all partners in the case of a member firm or all members in the case of a member corporation, unless for good cause shown the signature of one or more such persons is waived by the Exchange, certifying that such organization does not, and will not without first withdrawing such statement, carry margin accounts, free credit balances or securities in safekeeping for customers or make cash transactions for customers involving extensions of credit by such organization to, or the receipt by such organization of securities or monies from, customers and that such organization is not a clearing member of American Stock Exchange Clearing Corporation.

Amendments.
September 6, 1962.
June 1, 1970.
August 1, 1973.

¶ 9451 Organizations Doing Customer Business Must File Financial Reports

Rule 441. Every member organization which has not on file with the Exchange a statement made pursuant to Rule 440 and every individual member of the Exchange who is a clearing member of American Stock Exchange Clearing Corporation shall file with the Exchange at such times as the Exchange may direct, a statement in a form prescribed by the Exchange of its financial condition and the condition of its accounts, including free credit balances and securities in safekeeping. The statement shall be signed by such person or persons as the Exchange may direct. The provisions of this rule shall not apply to a member organization subject to the jurisdiction of another exchange unless the American Stock Exchange so directs.

Amendments.
August 4, 1960.
September 6, 1962.
June 1, 1970.
August 1, 1973.

¶ 9452 Disclosure of Financial Condition to Customers

Rule 442. Every member organization required under Rule 441 to submit reports of financial condition to the Exchange shall:

(a) within thirty-five days of the date after which the answer to each annual audited financial questionnaire is required to be filed with the Exchange, send to each customer either

(1) A statement of financial condition of the organization based upon such audit, including the independent public accountant's report on the statement of financial condition of the organization or, if the audit is not completed,

(2) a notice reading as follows:

"An audit of this organization as of (date) is now in process by independent public accountants. A financial statement of the firm (corporation), based on the audit now being conducted, will be mailed to all customers having an open account when such statements are available for distribution."

The financial statement based on the audited answers to the financial questionnaire shall be one which is prepared in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding audited statement, and shall include, in the basic statement or in accompanying footnotes, all informative disclosures necessary to make the statement a clear expression of the organization's financial condition and must be accompanied by the independent public accountant's report expressing an opinion on such statement; and

(b) make available at other times of the year at a customer's request or distribute to customers an unaudited statement of its financial condition based on its most recent report to the Exchange, or as of a date subsequent thereto, in a form approved by the Exchange.

Unaudited financial statements made available or distributed to customers at other times during the year shall follow in form and accounting principles the audited statements and shall be statements which in the opinion of the organization fairly present the financial condition of such organization.

Each monthly statement of account sent to a customer shall bear a legend reading as follows:

"A financial statement of this firm (corporation) is available for your personal inspection at its offices, or a copy of it will be mailed upon your written request."

• • • *Commentary*

.10 The term "customer" as used in the above Rule means any person or party who either at the time of requesting such a financial statement or at the time of the distribution of such annual statement has an open account with the member organization.

.20 Each member organization shall file with the Examinations Department of the Exchange, promptly after completion of the required annual audit, an exact copy of the statement of financial condition, based upon such audit, which the firm intends to submit to its customers. However, copies of other financial statements need not be filed with the Examinations Department unless the organization has not been in existence a sufficient length of time to have had such a required annual audit.

August 4, 1960.
September 6, 1962.
January 16, 1970.

¶ 9453 Independent Audits

Rule 443. The Exchange may require any member, member firm or member corporation to file with it, as of any date fixed by the Exchange, an audit, prepared by an independent public accountant, of his financial statements, in such form as the Exchange may prescribe. The Exchange shall require

the filing at least once in each twelve month period of such an audit by each member, member firm and member corporation transacting a business in securities directly with or for other than members of a national securities exchange, and carrying any margin account, credit balance or security for any customer. The provisions of this Rule shall not apply to a member firm or member corporation for which the Exchange is not the designated examining authority unless the American Stock Exchange so directs.

Amendments.
April 5, 1962.
September 6, 1962.
March 11, 1976.

¶ 9454 Reports of Member Indebtedness and Loans

Rule 444.

(a) Capital borrowings

Each member and member organization shall promptly report to the Exchange any borrowing regardless of its size or nature, where all or any part of the proceeds are placed in an account representing capital of such member or member organization.

(b) Non-capital borrowings

(1) Each member shall promptly report to the Exchange through a senior member designated by the organization any borrowings aggregating $20,000 or more, whether of cash, securities, or a combination of the two, which borrowing or borrowings are not reportable under paragraph (a) of this rule. However, no report shall be required with respect to the following non-capital borrowings:

(i) A borrowing fully secured by readily marketable collateral, as long as such borrowing remains so secured.

(ii) A borrowing on a life insurance policy which is not in excess of the cash surrender value of the policy.

(iii) A borrowing fully secured by real estate or chattel mortgage.

(c) Loans to members or member organizations

Each member and member organization shall promptly report to the Exchange any loan(s), whether of cash, securities, or a combination of the two, exceeding or aggregating $20,000 made to any member or member organization.

(Note: Regulation T also prohibits or imposes special conditions on certain borrowings and loans between the persons and organizations subject to this rule.)

(d) Exception

The provisions of paragraphs (a), (b) and (c) of this rule shall not apply to any loan transactions of a member or member organization required to report loan transactions to the New York Stock Exchange; provided, however, that this exception shall not be deemed to exempt the reporting by members and member organizations of any loans to or borrowings from any regular member of the American Stock Exchange which are reportable under this Rule.

Amendments.
September 6, 1962.
June 19, 1970.

• • • *Commentary*

.10 **Capital Borrowings**—The Exchange requires that the documents which evidence capital borrowings conform to certain standards and that copies be submitted to the Examinations Department for approval before the cash or securities involved may qualify as capital acceptable for inclusion in the computation of net capital under Rule 470.

The character of the documents varies, depending upon whether the lender is an individual, member of a national securities exchange, bank, estate, trust, corporation, partnership, etc.

Capital borrowings other than subordinated borrowings shall be executed on a time basis of at least six months' duration or, preferably, for a longer period of time. Subordinated borrowings shall ordinarily be made on a one-year basis, or longer. Capital borrowings of shorter duration are not acceptable, unless due to exceptional circumstances they have received the prior approval of the Exchange. It is therefore important that the Examinations Department be contacted prior to the consummation of any capital borrowing to be sure that the terms of the arrangement will permit the borrowed funds to be considered as capital under Rule 470.

A change in the amount, including any repayment, or in any of the terms of a capital borrowing shall be reported promptly to the Examinations Department in order that the Exchange will at all times have a current record of the status of borrowed capital.

.20 **Non-Capital Borrowings**—It shall be the responsibility of the designated senior member of each member organization to supervise non-capital borrowings by the members of the member organization to assure that these borrowings are in a form which does not create an obligation for the member organization and are not excessive in relation to the individual's net worth. Where necessary, the member organization may delegate this responsibility to more than one senior individual. A copy of any note or agreement executed in connection with a reportable non-capital borrowing should be submitted to the Examinations Department at the time the borrowing is made. Any subsequent changes in any such borrowing shall also be reported promptly.

.30 Newly admitted individuals and organizations having information to report under Rule 444(b) or (c) should make their reports as promptly as possible after the date of their admission.

.31 **Loans**—Capital or non-capital loans (including drawings) from member organizations to their own members need not be reported individually when made, but are reportable on the next financial questionnaire required by the Exchange.

Also not reportable are borrowings of securities made for the purpose of effecting delivery against a sale where money payment equivalent to the market value of the securities is made to the lender and the contract is marked approximately to the market.

.40 Reports in letter form should include: names of lender and borrower, amount (if securities, list and give current market value),

• • • *Commentary*

interest rate, date made, maturity date, description of collateral if any, copy of agreement or note if any, statement as to whether proceeds are to be used for a capital or non-capital purpose. These reports should also include disclosure as to any understanding to maintain a cash balance with the lender.

(The terms "member" and "member organization" are defined in Article I, Section 3, of the Constitution.)

Amendments.
June 19, 1970.
November 1, 1971.

¶ 9455 Weekly Statement of Obligations and Net Positions in Respect of Security Underwritings

Rule 445. Every member firm or member corporation having obligations in respect of security underwritings shall submit to the Exchange weekly a statement of such obligations and the net positions resulting therefrom in such form as the Exchange may direct. Such statements need not be filed by a member firm or member corporation which submits similar statements to another exchange of which it is a member.

Amendments.
September 6, 1962.

¶ 9491 Approval of Advertisements

Rule 481. Every advertisement of a member, member firm or member corporation shall be submitted to the Exchange for approval as to form of presentation prior to publication, unless the copy is in a general form previously approved. The provisions of this rule shall not apply to any advertisement of a member, member firm or member corporation subject to similar requirements of the New York Stock Exchange except that a copy of any advertisement referring to any security traded on the American Stock Exchange shall be filed with the Exchange.

Amendments.

September 6, 1962.
October 1, 1964.

J.P. FOLEY & COMPANY, INC.

v. 71 Civ. 2987

NEW YORK STOCK EXCHANGE and
AMERICAN STOCK EXCHANGE

June 9, 1976
10:15 A.M.

Trial Resumed

(In open court - jury not present)

THE COURT: Gentlemen, I have considered the points that you all made so effectively yesterday, and to the extent necessary I have reviewed the evidence and reviewed my copious notes of what you did say.

My decision on the motion is as follows, and I will explain the reasons after I announce the decision.

The American Stock Exchange's motion to dismiss is granted.

The New York Stock Exchange's motion to dismiss as to the claim based on Rule 10b-5 and the claim based on rescission and Section 20(a) are granted and the American Stock Exchange's motion to dismiss as to Section 6 claim is denied.

MR. LOFLIN: Your Honor, you just said the American Stock Exchange motion on Section 6 was denied.

Is that what you meant?

THE COURT: No, I did not mean that.

The New York Stock Exchange's motion to dismiss on this claim is denied.

To avoid misunderstanding, if I did not make it clear in the first instance, the American Stock Exchange's motion to dismiss is granted in full.

Let me dispose of that matter first by saying that there is no dispute, I think, that the only evidence against the American Stock Exchange has to do with the testimony of Mr. Ramsey as to the so-called American Stock Exchange luncheon, not the January 16th Bankers Club luncheon, and the isolated contacts, or at least the ad hoc accidental contacts, between Mr. Ramsey and Mr. Saul on the commuter train.

It is not clear, of course, from Mr. Ramsey's testimony, as to whether or not at the luncheon, or even with Mr. Saul, there was ever a discussion of the precise details of the Blair situation, the conversion problems, the bookkeeping problems, the shrinkage of income, the capital impairment, or capital deficiency at least, with regard to the net capital requirements. But I think either way the matter is observed, the motion should be granted.

If we assume that Mr. Ramsey's testimony should be taken at face value, that is, that we should not go behind his non-recollections, then of course there is nothing that would charge the American Stock Exchange with knowledge of the details.

And, in the circumstance, since I have already indicated that I agree with the American Stock Exchange that without such knowledge itdischarged its Section 6 duties by the establishment of a rule which provided for supervision of dual members by the New York Stock Exchange, which rule was tacitly approved, at least, by the SEC by non-action over a period of years; having expressed my view that that theory is sound, then unless personal knowledge can be chargeable to the American Stock Exchange, no reasonable juror could come to the conclusion that the American Stock Exchange acted unreasonably.

If, however, we adopt what I consider a more realistic analysis of the testimony and infer that although Mr. Ramsey could not remember what happened on those occasions, by which I do not mean to suggest that Mr. Ramsey's failure to recollect or that of the many witnesses who have failed to recollect was necessarily deliberate or any indication of a lack of candor on their

part, it could very well have been a desire to forget traumatic experiences; in any event, if we go beyond Mr. Ramsey's testimony and infer that at a luncheon with the American Stock Exchange, during the heat of the events which existed at that time, it was more than natural, and to be assumed, that Mr. Ramsey brought the American Stock Exchange generally up to date on the problems, as he had done with the creditors of the company on January 16th and immediately thereafter with the New York Stock Exchange and the SEC, I nevertheless believe that a reasonable juror could not conclude that the American Stock Exchange had not acted reasonably in the circumstance because the American Stock Exchange had a right to assume, knowing as they would have as part of such an assumed message by Mr. Ramsey, that Ramsey and his colleagues had brought the New York Stock Exchange up to date and fully informed them on Blair's affairs, as he had done with the Securities and Exchange Commission; and the American Stock Exchange had the right to assume that the New York Stock Exchange would supervise Blair appropriately in the circumstances and that the net capital problem, which would have been the same for both Exchanges, would have been as well regulated by the New York Stock Exchange as by itself, as would the other problems that Blair faced.

Indeed, I must say I also agree with the American Stock Exchange's view, completely aside from whether dual supervision is excused as a matter of law, that as a matter of fact, if dual or multiple supervision of a brokerage house were attempted, particularly in the confused situation of Blair, it would have created chaos rather than have made a contribution to the welfare of the customers of Blair or the members of the firm or creditors or anyone else having a financial interest in the situation.

Some day I hope I may have the opportunity or the time to write the opinion that somebody should write on the major question that you have raised in your earlier motions, Mr. Loflin, but for the moment I think this is all you need and you and your colleagues are excused from further participation in the case.

It has been a pleasure to work with you, and I am sure Mr. Fried will agree with that.

MR. LOFLIN: Thank you, your Honor. I am sure I am speaking for Mr. Reid and myself in stating that it has been a great pleasure to be able to try this case before this Court.

As you know, months ago there were three cases that raised essentially the same legal theory and there has been no definitive judicial decision in this area.

Of course, I would welcome it from this Court at any time.

Thank you.

THE COURT: All right.

Now we come to the motion of the New York Stock Exchange. We start with the same premise, of course, as to the basis upon which a motion to dismiss should be granted, that is, whether a reasonable jury could decide in favor of the plaintiff.

I have concluded that under the law, and particularly under the tests established in the Hochfelder or Ernst case, decided by the Supreme Court on March 30th. That no jury could reasonably decide that the New York Stock Exchange was guilty of a violation of Section 10b of the Act.

My rationale is that in the first instance the Exchange owed no direct duty, as I see it, to Mr. Foley and could be held liable, if at all, only as an aider and abettor. But I don't believe that it is desirable or necessary to press the distinction because, whether as a principal or as an aider and abettor, it seems to me that the proof is totally inadequate to establish the requisite element of scienter as defined by the Court in Hochfelder.

Service of 2 copies of the
within Brief is hereby
admitted this 15th day of
November 19 76
Signed H Zachariakos

Attorneys for Plaintiffs-Appellants

Service of 3 copies of the
within Brief is hereby
admitted this 9th day of
November 19 76
Signed [illegible]

Attorneys for Defendant
New Jersey Realty Co., Inc.

Service of 3 copies of the
within Brief is hereby
admitted this 9th day of
November 19 76
Signed Milbank Tweed Hadley & McCloy

Attorneys for Defendant
New York Stock Exchange, Inc.